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IN THE

Supreme Court of the United States

October Term, 1938

No. 169

THE UNITED STATES,
Petitioner

v.

FREDERICK PLEASANTS

ON A WRIT OF CERTIORARI TO THE COURT OF CLAIMS

BRIEF FOR RESPONDENT

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CITATIONS

CASES:

MISCELLANEOUS

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OPINION BELOW

The findings of fact and opinion of the Court of Claims of the United States (R. 11-29) are reported in 22 F. Supp. 964.

JURISDICTION

The judgment of the Court of Claims was entered on April 4, 1938. (R. 29.) The Government filed a petition for a writ of certiorari on July 1, 1938, and the same was granted on October 10, 1938. The jur-

isdiction of this Court is conferred by Section 3 (b) of the Act of February 13, 1925.

STATEMENT OF THE CASE

The sole controversy presented by this case is whether the respondent taxpayer is entitled to a deduction for income tax purposes for the contributions which he made to charitable institutions in the calendar year 1932.

During the year 1932, the respondent made charitable contributions of a character deductible under Section 23 (n) of the Revenue Act of 1932 in the amount of $3,496.00, and claimed a deduction for the same in his individual income tax return for that year. (R. 5; Fdg. 2, R. 12.)

The Commissioner of Internal Revenue in auditing the respondent's return for the year 1932 disallowed in its entirety the claimed deduction for contributions. The Commissioner determined the respondent's "net income," i. e., gross income less permissible deductions, to be $94,963.52, as computed without the benefit of any deduction for contributions. (Fdgs. 3 and 4, R. 12-13.) The respondent in the year 1932 sustained a "capital net loss" of $154,921.98, which was not a permissible deduction in the computation of the aforesaid net income of $94,963.52. (R. 5, 7; Fdgs. 3 and 4, R. 12-13.)

In the calculation of taxes, the Commissioner of Internal Revenue treated the said sum of $94,963.52 as the "net income," to be taxed under Sections 11 and 12, which prescribe the normal and surtax rates on net income, and against the taxes thus determined, he allowed, pursuant to Section 101 (b), a credit of 12½ per cent of the aforesaid capital net loss, the difference representing the tax due. The Commissioner determined the total tax assessable against the re-

spondent on his "net income" to be $1,070.69. (R. 5, 7-8; Fdgs. 3 and 4, R. 12-13.)

While the Commissioner employed the said sum of $94,963.52 as the "net income," taxable under Sections 11 and 12, he held that the respondent had no "net income," for the purpose of allowing a deduction for contributions. (R. 7-10; Fdgs. 3 and 4, R. 12-13.) Section 23 (n) limits the deduction for contributions to 15 per cent of the "net income," as computed without the benefit of the deduction.

In the Commissioner's view of the statute, the term "net income," as used in Section 23 (n), as applied to the facts of this case, means the "net income," subject to tax under Sections 11 and 12, *less* the nondeductible capital net loss. When the capital net loss of $154,921.98 is subtracted from the taxable net income of $94,963.52, a net loss of more than $59,000.00 is produced, (R. 12); and the base for measuring the 15 per cent limitation prescribed by Section 23 (n) is thereby wholly destroyed. The Commissioner held that although the respondent had a "net income," for the imposition of taxes, he had no "net income," within the purview of that term as used in Section 23 (n), and that therefore he was not entitled to any deduction for contributions.

In our view of the statute, the respondent's "net income," $94,963.52, which was subjected to tax under Sections 11 and 12, is the base for the calculation of the 15 per cent limitation under Section 23 (n), because it represents the respondent's net income as computed without the benefit of the deduction for contributions, and since the respondent's contributions of $3,496.00 are well within the prescribed limitation, they are deductible in full.

We cannot subscribe to the Commissioner's view that the respondent here has a "net income" subject

to tax under Sections 11 and 12 for the year 1932, and at the same time has a "net loss," for the year 1932 for the purpose of Section 23 (n).

THE QUESTION AT ISSUE

The question at issue is simply this: Is the respondent under the facts of his case entitled to a deduction for income tax purposes for the contributions in the sum of $3,496.00 which he made to charitable institutions in the calendar year 1932?

The base for measuring the 15 per cent limitation on the amount allowable as a deduction for contributions under Section 23 (n) is "net income," as computed without the benefit of the deduction. Did the respondent have a "net income," within the purview and contemplation of that term as used in Section 23 (n), and other parts of the Act? Did Congress by the use of the term "net income," appearing in Section 21 intend to provide a base for the calculation of the taxes? Does the respondent have a "net income," of $94,963.52 subject to the normal and surtaxes prescribed by Sections 11 and 12, and at the same time have a "net loss," of more than $59,000.00 for the purpose of Section 23 (n) Why the discrimination? Did Congress intend to attach conflicting meanings to the term "net income," in the case of a taxpayer who sustained a "capital net loss," which is excluded in the computation of taxable net income? Congress, commencing with the Revenue Act of 1924, legislated against the deduction of a "capital net loss," in computing net income subject to tax. Does the Commissioner of Internal Revenue have the right to deduct a nondeductible "capital net loss," and thereby impair or destroy the base specified in Section 23 (n) for measuring the 15 per cent limitation on the amount deductible for contributions? Did Congress

intend to deny to a taxpayer a deduction for a "capital net loss," and at the same time grant to the Commissioner the right to deduct it for the purpose of reducing or denying altogether a deduction for contributions? Is there any language in the Act which supports such an anomalous process?

THE FACTS

The findings of fact of the Court of Claims may be summarized as follows:

The respondent filed his individual income tax return for 1932 on March 15, 1933, showing a total tax of $161.77, which was paid on the same date. In that return he reported in line 12 a total income of $99,123.31 consisting of salaries, interest, and dividends, and on line 19 of the return he reported total deductions of $5,235.15 consisting of taxes paid, losses by fire, storm, etc., and under item 17, contributions. The respondent also reported in line 32 of the return under the heading "Computation of Tax" a capital net loss of $157,642.62. The respondent in his return for 1932 reported his income, deductions, losses, and tax as follows:

INCOME

Item and Instruction No.			
1.	Salaries, Wages, Commissions, Fees, etc. Nat. Bellas Hess Co., New York		$ 900.00
	" " " " " " rector's fees		120.00
3.	Interest on Bank Deposits, Notes, Corporation Bonds, etc. (except interest on tax-free covenant bonds)		10,988.62
9.	Taxable Interest on Liberty Bonds, etc. (from Schedule E)		922.25
10.	Dividends on: (a) Stock of Domestic Corporations subject to taxation under Title I of 1932 Act		85,761.94
	(c) Stock of Foreign Corporations and bonds		430.50
12.	Total Income in Items 1 to 11		$99,123.31

DEDUCTIONS

14.	Taxes Paid. (Explain in Schedule F)		$ 1,639.15
15.	Losses by Fire, Storm, etc. (Explain in Table at foot of page 2)		100.00
17.	Contributions (Explain in Schedule F)		3,496.00
19.	Total Deductions in Items 13 to 18		$ 5,235.15
20.	Net Income (Item 12 minus Item 19)		$93,888.16
	COMPUTATION OF TAX (See Instruction 23)		
23.	Net Income Subject to Tax		$93,888.16
24.	Less: Interest on Liberty Bonds, etc. (Item 9)	$ 922.25	
25.	Dividends (Item 10(a))	85,761.94	
26.	Personal Exemption	2,500.00	
28.	Total of Items 24 to 27	$89,184.19	89,184.19
29.	Balance subject to Normal Tax (Item 23 minus 28)		$ 4,703.97
30.	Amount taxable at 4% (not over $4,000)		4,000.00
31.	Amount taxable at 8% (Item 29 minus 30)		703.97
32.	Amount of Capital Net Gain or Loss (from Schedule D) (loss)		$157,642.62
33.	Normal Tax (4% of Item 30)		$ 160.00
34.	Normal Tax (8% of Item 31)		56.31
35.	Surtax on Item 22 (See Instruction 23)		19,650.79
36.	Tax on net income (total of Items 33 to 35)		19,867.10
37.	Adjustment for Capital Gain or Loss (12½% of Item 32)		19,705.33
38.	Total Tax (total of or difference between Items 36 and 37)		$ 161.77

(R. 5; Fdg. 1, R. 12.)

In arriving at the total deduction of $5,235.15 shown on line 19 of this return, the respondent included therein as a deduction the amount of $3,496.00, representing contributions or gifts made by him within the taxable year 1932 to the St. James' Church, Community Chest, Red Cross, Salvation Army, Y. M. C. A., and other charitable institutions, within the purview of Section 23 (n) of the Revenue Act of 1932. (Fdg. 2, R. 12.)

The Commissioner of Internal Revenue caused an investigation and audit to be made of respondent's books and records, and his return for 1932, and, on January 20, 1934, pursuant to the instructions of the Commissioner, the Internal Revenue Agent in Charge at Newark, New Jersey, made such investigation and audit and on February 20, 1934, prepared and submitted a report to the Commissioner, showing the following:

Schedule No. 1

BLOCK ADJUSTMENTS

		Return	Additions to income	Deductions from income	Corrected
1	Salaries	1,020.00			1,020.00
2					
3	Interest	10,988.62			10,988.62
4					
5					
6					
7					
8	Profit on mortgages			(a) (2,420.64)	(2,420.64)
8a					
9	Liberty bond interest	922.25			922.25
10	Dividends	85,761.94			85,761.94
	(c) Bonds	430.50			430.50
12		99,123.31			96,702.67
13					
14	Taxes	1,639.15			1,639.15
15	Losses	100.00			100.00
16					
17	Contributions	3,496.00	(b) 3,496.00		
18					
		5,235.15			1,739.15
	Total income	93,888.16	3,496.00	(2,420.64)	94,963.52

			Year
		Schedule No. 2	Period ended 1932

COMPUTATION OF TAX

Net income (from Schedule 1)			$94,963.52
Less: Net loss (section 117 of 1928 or 1932 Act)			
Capital net gain			
Income subject to surtax			$94,963.52
Less: Dividends		$85,761.94	
Interest on Liberty Bonds, etc.		922.25	
Personal exemption and credit for dependents		2,500.00	89,184.19
Balance subject to normal tax			$ 5,779.33
Normal tax at 4% on	$ 4,000.00	$ 160.00	
Normal tax at 8% on	$ 1,779.33	142.35	
Surtax on	$94,963.52	20,133.58	
Tax at 12½% on capital net loss of $154,921.98		(19,365.24)	$ 1,070.69
Total tax			$ 1,070.69
Total tax assessable			$ 1,070.69
Tax previously assessed			161.77
Additional tax to be assessed			$ 908.92

The Internal Revenue Agent in Charge determined the respondent's gross income to be $96,702.67 instead of $99,123.31, as reported by the respondent on line 12 of his return, and the total deductions to be $1,-739.15 instead of $5,235.15, as reported by the respondent on line 19 of his return. In so reducing the total deductions from $5,235.15, as reported by plaintiff, to $1,739.15, the Internal Revenue Agent in Charge disallowed as a deduction the charitable contributions in the amount of $3,496.00, as set forth in finding 2 of the Court below, on the ground that the capital net loss was a proper deduction in determining the "net income" for the purpose of the deduction for charitable contributions under Section 23 (n), and since the ordinary net income reduced by the capital net loss resulted in a net loss for the year there was no income against which to apply the deduction for charitable contributions. The Internal Revenue Agent in Charge also determined plaintiff's capital net loss to be $154,921.98 instead of $157,-642.62, as reported on line 32 of the return. The total tax assessable against the respondent as shown in the audit by the Internal Revenue Agent in Charge as set forth in his report hereinbefore mentioned was $1,070,69, or $908.92 in excess of $161.77, which amount the respondent had reported and paid as set forth in finding 1 of the Court below. This additional tax resulted entirely from the disallowance of the deduction for charitable contributions in determining net income subject to tax. (R. 7-9; Fdg. 3, R. 12-13.)

The Commissioner upon examination and audit of respondent's return in connection with the report of the Internal Revenue Agent in Charge, approved the findings, audit, and computation of the tax recommended by the Revenue Agent in Charge and so notified the respondent on April 13, 1934. The respon-

dent's taxable net income for 1932 was $94,963.52 before any deduction for charitable contributions. The deficiency in tax of $908.92, together with interest thereon of $60.87, aggregating $969.79, was thereafter assessed and upon demand the same was paid May 12, 1934. (R. 9-10; Fdg. 4, R. 13.)

Thereafter, May 19, 1934, the respondent duly filed a timely claim for refund for $969.79 for 1932 on the ground that the amount of $3,496.00 representing contributions to charity, being less than 15 per cent of his taxable net income, was a proper and legal deduction under Section 23 (n) of the Revenue Act of 1932 in computing his net income subject to tax. The Commissioner rejected this claim in its entirety on January 17, 1935, giving as his reasons therefor the following:

> "In this connection you are advised that in the cases of Susan Dwight Bliss v. Commissioner and William Albert Harbison v. Commissioner, decided November 5, 1934, the Supreme Court of the United States decided that the base for computing the 15 per cent limitation on contributions is the gross income less all permissible deductions save contributions, regardless of whether the tax is computed under the capital net gain or net loss provisions of the Revenue Acts prior to the Revenue Act of 1934.
>
> "In accordance with the above decision the ordinary net income must be reduced by the amount of the capital net loss in order to arrive at the base on which to compute the 15 per cent limitation for contributions. Since the capital loss of $154,921.98 is in excess of adjusted ordinary net income of $94,963.52 (without contributions) there is no net income against which to make a deduction for contributions. Contributions claimed in the amount of $3,496.00 cannot therefore be allowed."

(R. 10; Fdg. 5, R. 13-14.)

THE STATUTE

The pertinent parts of the Revenue Act of 1932 are as follows:

SUBTITLE B—GENERAL PROVISIONS

Part I—Rates of Tax

SEC. 11. NORMAL TAX ON INDIVIDUALS.

There shall be levied, collected, and paid for each taxable year upon the net income of every individual a normal tax equal to the sum of the following:

(a) 4 per centum of the first $4,000 of the amount of the net income in excess of the credits against net income provided in section 25; and

(b) 8 per centum of the remainder of such excess amount.

SEC. 12. SURTAX ON INDIVIDUALS.

(a) Rates of Surtax.—There shall be levied, collected, and paid for each taxable year upon the net income of every individual a surtax as follows:

Upon a net income of $6,000 there shall be no surtax; upon net incomes in excess of $6,000 and not in excess of $10,000, 1 per centum of such excess.

$40 upon net incomes of $10,000 and upon net incomes in excess of $10,000 and not in excess of $12,000, 2 per centum in addition to such excess. * * *

$491,460 upon net incomes of $1,000,000; and upon net incomes in excess of $1,000,000, 55 per centum in addition of such excess.

Part II—Computation of Net Income

SEC. 21. NET INCOME.

"Net income" means the gross income computed under section 22, less the deductions allowed by section 23.

SEC. 22. GROSS INCOME.

(a) General Definition.—"Gross income" includes gains, profits, and income derived from salaries, wages, or compensation for personal service, of whatever kind and in whatever form paid, or from professions, vocations, trades, businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever. * * *

SEC. 23. DEDUCTIONS FROM GROSS INCOME.

In computing net income there shall be allowed as deductions:

(a) Expenses * * *; (b) Interest * * *; (c) Taxes Generally * * *; (d) Taxes of Shareholder Paid by Corporation * * *;

(e) Losses by Individuals.—Subject to the limitations provided in subsection (r) of this section, in the case of an individual, losses sustained during the taxable year and not compensated for by insurance or otherwise—

(1) if incurred in trade or business; or

(2) if incurred in any transaction entered into for profit, though not connected with the trade or business;

(3) of property not connected with the trade or business, if the loss arises from fires, storms, shipwreck, or other casualty, or from theft. No loss shall be allowed as a deduction under this paragraph if at the time of the filing of the return such loss has been claimed as a deduction for estate tax purposes in the estate tax return.

(f) Losses by Corporations * * *; (g) Basis for Determining Loss * * *; (h) Loss on Wash Sales of Stock or Securities * * *; (i) Net Losses

* * *; (j) Bad Debts * * *; (k) Depreciation * * *; (l) Depletion * * *; (m) Basis for Depreciation and Depletion * * *;

(n) Charitable and Other Contributions.—In the case of an individual, contributions or gifts made within the taxable year to or for the use of: * * *

(2) A corporation, or trust, or community chest, fund, or foundation, organized and operated exclusively for religious, charitable, scientific, literary, or educational purposes, or for the prevention of cruelty to children or animals, no part of the net earnings of which inures to the benefit of any private shareholder or individual: * * *

to an amount which in all the above cases combined does not exceed 15 per centum of the taxpayer's net income as computed without the benefit of this subsection. Such contributions or gifts shall be allowable as deductions only if verified under rules and regulations prescribed by the Commissioner, with the approval of the Secretary. (For unlimited deduction if contributions and gifts exceed 90 per centum of the net income, see section 120.) (Italics supplied.)

(o) Future Expenses in Case of Casual Sales of Real Property * * *; (p) Dividends Received by Corporations * * *; (q) Pension Trusts * * *;

(r) Limitation on Stock Losses.—

(1) Losses from sales or exchanges of stock and bonds (as defined in subsection (t) of this section) which are not capital assets (as defined in section 101) shall be allowed only to the extent of the gains from such sales or exchanges (including gains which may be derived by a taxpayer from the retirement of his own obligations.) * * *

(s) Same—Short Sales * * *; (t) Definition of Stocks and Bonds * * *

SUBTITLE C—SUPPLEMENTAL PROVISIONS

Supplement A—Rates of Tax

(Supplementary to Subtitle B, Part 1)

SEC. 101. CAPITAL NET GAINS AND LOSSES.

(a) Tax in case of capital net gain.—In the case of any taxpayer other than a corporation, who for any taxable year derives a capital net gain (as hereinafter defined in this section), there shall at the election of the taxpayer, be levied, collected, and paid, in lieu of all other taxes imposed by this title, a tax determined as follows: A partial tax shall first be computed upon the basis of the ordinary net income at the rates and in the manner as if this section had not been enacted and the total tax shall be this amount plus 12½ per centum of the capital net gain.

(b) Tax in case of capital net loss.—In the case of any taxpayer, other than a corporation, who for any taxable year sustains a capital net loss (as hereinafter defined in this section), there shall be levied, collected, and paid, in lieu of all other taxes imposed by this title, a tax determined as follows: a partial tax shall first be computed upon the basis of the ordinary net income at the rates and in the manner as if this section had not been enacted, and the total tax shall be this amount minus 12½ per centum of the capital net loss but in no case shall the tax of a taxpayer who has sustained a capital net loss be less than the tax computed without regard to the provisions of this section.

(c) Definitions.—For the purposes of this title—

(1) "Capital gain" means taxable gain from

the sale or exchange of capital assets consummated after December 31, 1921.

(2) "Capital loss" means deductible loss resulting from the sale or exchange of capital assets.

(3) "Capital deductions" means such deductions as are allowed by section 23 for the purpose of computing net income, and are properly allocable to or chargeable against capital assets sold or exchanged during the taxable year.

(4) "Ordinary deductions" means the deductions allowed by section 23 other than capital losses and capital deductons.

(5) "Capital net gain" means the excess of the total amount of capital gain over the sum of (A) the capital deductions and capital losses, plus (B) the amount, if any, by which the ordinary deductions exceed the gross income computed without including capital gains.

(6) "Capital net loss" means the excess of the sum of the capital losses plus the capital deductions over the total amount of capital gain.

(7) "Ordinary net income" means the net income, computed in accordance with the provisions of this title, after excluding all items of capital gain, capital loss, and capital deductions.

(8) "Capital assets" means property held by the taxpayer for more than two years (whether or not connected with his trade or business), but does not include stock in trade of the taxpayer or other property of a kind which would properly be included in the inventory of the taxpayer if on hand at the close of the taxable year, or property held by the taxpayer primarily for sale in the course of his trade or business. * * *

(d) Collection and payment of tax.—The total tax determined under subsection (a) or (b) shall be collected and paid in the same manner at the same time, and subject to the same provisions of law, including penalties, as other taxes under this title.

JUDICIAL HISTORY OF THE CONTROVERSY

The judicial history of the controversy as to the measure of the base for the calculation of the 15 per cent limitation on the amount allowable as a deduction for charitable contributions where the taxpayer sustained a nondeductible *capital net loss* is covered by the following cases:

> *Elkins* v. *Commissioner*, 24 B.T.A. 572 (decided November 3, 1931) (NA) Cumulative Bulletin XI-1, p. 9; (A) Cumulative Bulletin XII-1, p. 4. Board Member Trussell, who prepared the opinion in this case during his term of office, did not participate in the later consideration of the same question, because of his death, which occurred on October 23, 1931.
>
> *Livingood* v. *Commissioner*, 25 B.T.A. 585 (decided February 23, 1932) (NA) Cumulative Bulletin XI-1, p. 10; (A) Cumulative Bulletin XII-1, p. 8.
>
> *Lockhart* v. *Commissioner*, 32 B.T.A. 732 (decided June 10, 1935), affirmed (CCA 3) March 16, 1937, 89 F. (2d) 143, certiorari denied.
>
> *Avery* v. *Commissioner*, 32 B.T.A. 948 (decided July 16, 1935), affirmed (CCA 7) June 30, 1936, 84 F (2d) 905, certiorari denied.

The fact that this Court denied certiorari in the *Avery* and *Lockhart* cases, supra, is not decisive of the question here presented for decision. As was well said by Mr. Justice Holmes speaking for the Court in *Atlantic Coast Line R. Co.* v. *Powe*, 283 U. S. 401, 403-404:

> "* * * But 'The denial of a writ of certiorari imports no expression of opinion upon the merits of the case, as the bar has been told many times.' United States v. Carver, 260 U. S. 482, 490, 67 L. ed. 361, 364, 43 S. Ct. 181."

This Court has not expressed its views on the precise point in issue in this case.

The question at issue is presently pending before the Third Circuit on petition for rehearing in *Howard Heinz* v. *Commissioner*, 34 B.T.A. 885 (decided August 7, 1936), affirmed (CCA 3) February 11, 1938, 94 F. (2d) 832, and before the same Circuit in *John E. Zimmerman* v. *Commissioner*, 36 B.T.A. 618 (decided October 7, 1937), on appeal from the Board's decision.

The same issue is also pending before the Eighth Circuit in *Watkins v. Commissioner, Moulton* v. *Commissioner* and *Johnson* v. *Commissioner*, on appeal from a memorandum decision of the Board of Tax Appeals.

This Court in *Helvering* v. *Bliss*, 293 U. S. 144, held that the base under Section 23 (n) for the calculation of the 15 per cent limitation on the amount deductible for charitable contributions, where the taxpayer's taxable *net income* consisted of both (1) ordinary net income subject to the normal and surtaxes under Sections 11 and 12, and (2) capital net gain taxed specially at 12½ per cent under Section 101 (a), was the total of the two parts as computed without the benefit of the deduction for contributions, and that the deduction for contributions was an *ordinary deduction* in the computation of the taxpayer's *ordinary net income.*

In the case at bar, the taxpayer's sole *net income* consists of ordinary net income, but the Commissioner of Internal Revenue refuses to permit a deduction for contributions in ascertaining that net income.

ARGUMENT

I

The base for calculating the 15 per cent limitation under Section 23 (n) on the amount allowable as a deduction for contributions is the taxpayer's taxable "net income," as computed without the benefit of the deduction, and not such net income diminished by a nondeductible capital net loss.

Congress adopted the term "net income," and prescribed the standards for its computation with a view to providing a readily ascertainable base for the calculation of the tax, and it is that base, as computed before the deduction for contributions is taken, which measures the 15 per cent limitation under Section 23 (n) on the amount allowable as a deduction for contributions. Article 261 of Regulations 77 under the 1932 Act dealing with the deductions for contributions is in harmony with the statute.

The respondent's taxable *net income* consists entirely of his *ordinary net income* of $94,963.52. (Fg. 4, R. 13.) The Commissioner treated it as the respondent's *net income* subject to tax under Sections 11 and 12 of the Revenue Act of 1932. While the Commissioner of Internal Revenue maintains that the respondent has a *net income* within the purview of that term as used in Sections 11 and 12 of $94,963.52 and levies a tax thereon, he contends that for the purpose of Section 23 (n) the respondent has a *net loss* of more than $59,000.00, which is produced by deducting the nondeductible *capital net loss* of $154,921.98 sustained by the respondent in the year 1932.

Congress originally introduced the capital net loss provisions by Section 208 of the Revenue Act of 1924, and were subsequently reenacted by Section 208 of the Revenue Act of 1926, and by Section 101 of the Rev-

enue Acts of 1928 and 1932. The Revenue Act of 1934 by Section 117 produced a change.

The Commissioner of Internal Revenue in the administration of the Revenue Acts of 1924, 1926, 1928 and 1932 has consistently held that a *capital net loss* was not a permissible deduction in the computation of net income subject to tax. This is a correct interpretation of the statute, and we do not challenge the same. Section 101 (c) (6) of the Revenue Act of 1932 provides as follows:

> "(6) 'Capital net loss' means the excess of the sum of the capital losses plus the capital deductions over the total amount of capital gain."

It means the *net loss* on the sale of assets held by a taxpayer for more than two years, and such net loss is not a permissible deduction in computing taxable net income.

The confusion which has heretofore existed on the question at issue resulted from a failure to recognize the difference between a deductible *capital loss*, as defined by Section 101 (c) (2), and a nondeductible *capital net loss*, as defined by Section 101 (c) (6). Section 101 (c) (2) defines a *capital loss* as follows:

> "(2) 'Capital loss' means deductible loss resulting from the sale or exchange of capital assets."

Capital losses are deductible from *capital gains* in ascertaining a *capital net gain*, as defined by Section 101 (c) (5), which is taxed specially at 12½ per cent. *Capital losses* are deductible to the extent of the *capital gains* in ascertaining a *capital net loss*. The excess of the *capital losses* over *capital gains* is a *capital net loss* which is excluded in the computation of the net income which is subjected to tax under the Act.

A *capital net loss* is the base under Section 101 (b)

for the allowance of a credit of 12½ per cent thereof against the normal and surtaxes levied on the taxable net income under Sections 11 and 12. If Congress had only allowed a credit of 1 per cent, the issue would still be the same. The *capital net loss* to the extent of 12½ per cent thereof was allowed as a credit against the normal and surtaxes, in the same manner as Sections 31 and 32 allow a credit against tax for foreign income and profits taxes, and taxes withheld at the source under Section 143. A *capital net loss* is excluded in the computation of taxable net income.

In *Piper* v. *Willcuts*, (CCA 8), 64 F. (2d) 813, affirming 55 F. (2d) 397, and *Hoffman* v. *Commissioner*, (CCA 2), 71 F. (2d) 929, it was expressly ruled that a loss of the character sustained by the respondent here constituted a *capital net loss*, which was not a permissible deduction. In *Piper* v. *Willcuts*, supra, Circuit Judge Van Valkenburgh, quoting from the trial judge, said:

> "The Commissioner of Internal Revenue determined a deficiency in the plaintiff's tax liability for the calendar year 1927 of $1,528.82, holding that the loss from the sale of the stock in question constituted a 'capital net loss' within the meaning of Section 208 (a) (6) of the Revenue Act of 1926 (title 26, USCA sec. 939 note), and that *it was therefore not a proper deduction from the plaintiff's gross income* * * *."

Piper sold 300 shares of stock of a certain company at a loss of $29,996.00, the said stock having been held by him for more than two years. Piper claimed a deduction for the *capital loss* on the ground that since he had no *capital gains*, the loss was not a *capital net loss* within the meaning of that term as used in Section 208 (a) (6) of the Revenue Act of 1926. The Court held that the loss constituted a *capital net loss* and therefore not deductible. The existence of a *capital gain* is not

a prerequisite to the existence of a *capital net loss.*

The loss in the case at bar is of a similar nature to that which existed in *Piper* v. *Willcuts*, supra. The respondent here sustained a loss of $154,921.00 on the sale of 19,482 shares of stock of a certain company which he held for more than two years. He had no *capital gains.* (R. 8.) Pleasants did not claim a deduction for the loss, and we do not challenge the correctness of the rule of *Piper* v. *Willcuts*, supra. The Commissioner of Internal Revenue recognizes that rule for all purposes, except Section 23 (n).

This Court in *Helvering* v. *Bliss*, supra, ruled that the base specified in Section 23 (n) was the taxpayer's total net income—the base for the calculation of the tax—as computed without the benefit of the deduction for contributions. In that case, Bliss had two different kinds of *net income* (1) net income consisting of ordinary net income subject to the normal and surtax rates under Sections 11 and 12, and (2) net income consisting of *capital net gain* taxed specially at 12½ per cent under Section 101 (a). This Court held that the total of the two parts constituted Bliss' *net income* within the meaning of that term as used in Section 23 (n). The Commissioner in the *Bliss* case contended that the 15 per cent limitation applied solely to *ordinary net income*, while the taxpayer maintained it applied to the entire net income. This Court held that the *capital net gain* existing in that case constituted a part of *net income.*

The *Bliss* case, while not controlling the case at bar because the issue here was not involved therein, does lend great aid in the solution of the present problem.

In the *Bliss* case, 293 U. S. 144, 146-147, this Court, speaking through Mr. Justice Roberts, said:

> "For 'net income,' the base specified in Section 23 (n) upon which the 15 per cent deduction of

> charitable contributions is to be calculated, the petitioner (Commissioner) would substitute 'ordinary net income' as defined in Section 101. So to read the Act would violate its plain terms and run counter to the history of the legislation."

The Commissioner places reliance on the above language to support his action in denying a deduction for contributions to the respondent here. The Commissioner is of the view that *net income* consisting of *ordinary net income* cannot be the base for the calculation of the 15 per cent limitation, yet this Court in the *Bliss* case recognized that such net income was part of the base.

The rule is that the language of any opinion is to be considered in the light of the facts of the particular case which was decided. In *Cohens* v. *Virginia*, 6 Wheat. 264, 399, 19 U. S., Chief Justice Marshall made the following pertinent observation:

> "It is a maxim not to be disregarded, that general expressions, in every opinion, are to be taken in connection with the case in which those expressions are used. If they go beyond the case, they may be respected, but ought not to control the judgment in a subsequent suit when the very point is presented for decision."

Also see *Webster* v. *Fall*, 266 U. S. 507, 511; *United States* v. *Anderson*, et al., 269 U. S. 422, 442; *United States* v. *Mitchell*, 271 U. S. 9, 14.

When the Commissioner in the *Bliss* case substituted *ordinary net income* for *net income*, the base specified in Section 23 (n), he pursued a course of action which was wholly improper. To illustrate the injustice of the Commissioner's view of the statute, in *Straus* v. *Commissioner*, 27 B. T. A. 1116, involving the same issue as in the *Bliss* case, affirmed 74 F. (2d) 470, on the authority of the *Bliss* case, the taxpayer in the year

1929 donated $144,695.04 to charity, but the Commissioner reduced the allowable deduction to $6,461.99. Straus had an *ordinary net income* of $43,079.90 and a *capital net gain* of $766,463.96, both as computed without the benefit of a deduction for contributions. The Commissioner maintained that Straus was only entitled to a deduction of $6,461.99, being 15 per cent of the taxpayer's ordinary net income, but upon final decision Straus received a deduction of $121,431.79, being 15 per cent of his entire net income as computed without the benefit of the deduction.

When the Commissioner substituted *ordinary net income* for *net income* under Section 23 (n) in a capital net gain case, his action was obviously wrong.

The Board in the *Straus* case, supra, holding that the 15 per cent limitation was to be calculated on the taxpayer's entire taxable net income, overruled its prior decisions in *Ralph W. Harbison*, 26 B. T. A. 896, *Susan Dwight Bliss*, 27 B. T. A. 205, and *Mary Colgate*, 27 B. T. A. 506, which held that the 15 per cent applied merely to net income consisting of ordinary net income. The *Harbison* and *Bliss* cases were subsequently decided by this Court, 293 U. S. 144. The Board in the *Straus* case, did not as suggested by the Government, overrule its decision in *Hallie D. Elkins*, 24 B. T. A. 572 and *Charles J. Livingood*, Executor, 25 B. T. A. 585, which permitted a deduction for contributions based on taxable net income where the taxpayer sustained a nondeductible *capital net loss*. The Board in the *Straus case*, 27 B. T. A. 1116, 1119, said:

> "* * * The cases involving capital net losses may or may not be distinguished from those involving capital net gains. We express no opinion on that subject, but confine ourselves strictly to the question before us. * * *."

In the case at bar, the respondent's net income con-

sists solely of his *ordinary net income* of $94,963.52. This was his taxable net income as computed before any deduction for charitable contributions, and was so found by the Court below. (Fdg. 4, R. 13.) The Commissioner in the computation of the said net income of $94,963.52 did *not* allow any deduction for the respondent's *capital net loss* of $154,921.98, because a capital net loss is not a permissible deduction in computing net income subject to tax. This is a correct interpretation of the statute. The Commissioner employed the said sum of $94,963.52 as the respondent's final net income—the base for the calculation of the tax under Sections 11 and 12, and then allowed as a credit against the taxes thus determined 12½ per cent of the capital net loss pursuant to Section 101 (b). The Commissioner held, however, that the respondent had no "net income," for the purpose of Section 23 (n).

For *net income*, the base specified in Section 23 (n), the Commissioner would now substitute a *net loss* of more than $59,000.00 by deducting the nondeductible *capital net loss* from the respondent's taxable net income. In our view of the statute, a taxpayer has a base under Section 23 (n) if he has a net income subject to tax.

This Court in the Bliss case, 294 U. S. 144, 147, further said:

> "The scheme of all the Revenue Acts since that of 1916 has been to sweep all income of every sort, including capital gains, into what is denominated gross income and to authorize certain deductions therefrom in order to arrive at net income—*the base for calculation of the tax.* In the Act of October 3, 1917, Congress, in order to encourage gifts to religious, educational and other charitable objects, granted the privilege of deducting such gifts from gross income, but limited the total deduction to 15 per cent of the taxpayer's net income, calculated in the first in-

stance without reference to the amount of such contributions. All of the later Acts have contained a like provision. The Acts provide that the taxpayer shall first deduct from gross income the total of all permissible deductions save that for contributions, thus arriving at a provisional net income, and then deduct therefrom his contributions, but in no event to an amount greater than fifteen per cent of the provisional net income. By the last mentioned operation the final net income—*the base for calculation of the tax*—is ascertained. * * *." (Italics supplied.)

The above is an excellent statement of the applicable law, and applies with equal force here.

The respondent here had a gross income of $96,702.67. The total of his permissible deductions save that for contributions was $1,739.15. His provisional net income was $94,963.52. (R. 7-8.) If respondent is entitled to a deduction for his contributions of $3,496.00, his final net income is $91,467.52. The Commissioner treated $94,963.52 as the respondent's final net income—the base for calculation of the tax—under Sections 11 and 12, but for *net income*, the base specified in Section 23 (n), he substituted a *net loss* of more than $59,000.00. So to read the Act also violates its plain terms and runs counter to the history of the legislation. It nullifies and defeats the beneficent purpose of Section 23 (n) to encourage contributions to charitable institutions. Congress intended to give taxpayers a saving in tax if they donated to charity. The Commissioner by his action in this case thwarts that policy.

This case affects that class of taxpayers who were benevolently minded and contributed substantial sums to charitable institutions notwithstanding their own financial misfortune. The injustice of the Commis-

sioner's position is illustrated by the following example:

TAXPAYER "A"

INCOME

Item and Instruction No.			
1.	Salaries	$ 50,000.00	
3.	Interest	10,000.00	
7.	Rents and Royalties	440,000.00	
12.	Total Income		$500,000.00

DEDUCTIONS

13.	Interest Paid	$10,000.00	
14.	Taxes Paid	40,000.00	
17.	Contributions	50,000.00	
19.	Total Deductions		100,000.00
20.	Net Income		$400,000.00
22.	Net Income for Tax Computation		$400,000.00
	COMPUTATION OF TAX (See Instruction 23)		
23.	Net Income Subject to Tax		$400,000.00
26.	Less, Personal Exemption		2,500.00
29.	Balance Subject to Normal Tax		$397,500.00
30.	Amount taxable at 4%		$ 4.000.00
31.	Amount taxable at 8%		$393,500.00
32.	Amount of Capital Net Gain or Loss (From Schedule D)	(loss)	$550,000.00
33.	Normal Tax (4% of Item 30)		160.00
34.	Normal Tax (8% of Item 31)		31,480.00
35.	Surtax on Item 22		171,960.00
36.	Tax on Net Income (total of Items 33 to 35)		$203,600.00
37.	Adjustment for Capital Gain or Loss (12½% of Item 32)		68,750.00
38.	Total Tax (total of or difference between Items 36 and 37)		$134,850.00

In the foregoing example, TAXPAYER "A," in the year 1932 donated $50,000.00 to charitable institutions. He reported a "net income," within the meaning of that term as used in Sections 11 and 12 of $400,000.00 after deducting contributions, and a "capital net loss," within the meaning of that term as used in Section 101 (c) (6) of $550,000.00. His normal and surtaxes under Sections 11 and 12 on his "net income," of $400,000.00 were shown to be

$203,600.00, against which he applied a credit of $68,750.00 representing 12½% of his capital net loss of $550,000.00. He reported the difference, or $134,-850.00, as the total tax due.

Now, what happens in the case of TAXPAYER "A"? The Commissioner of Internal Revenue after an audit of TAXPAYER "A's" return would issue to him a notice of deficiency in tax disallowing in its entirety the deduction of $50,000.00 for contributions, because his capital net loss of $550,000.00 exceeded his "net income," subject to the normal and surtaxes imposed by Sections 11 and 12. According to the Commissioner of Internal Revenue TAXPAYER "A," has no "net income," within the contemplation of that term as used in Section 23 (n), because the base for the allowance of contributions where the taxpayer sustained a capital net loss, which is excluded in the computation of "net income," subject to the normal and surtaxes imposed by Sections 11 and 12, is "ordinary net income," as defined by Section 101 (c) (7), minus "capital net loss," as defined by Section 101 (c) (6). TAXPAYER "A," is thereby deprived of a deduction for contributions. Must TAXPAYER "A," under the facts of his case surrender his deduction for contributions? The denial of the deduction for contributions in his case would produce a deficiency in tax of $30,000.00, but the beneficent purpose of Congress in the enactment of Section 23 (n) is wholly defeated. Is this in accordance with the Congressional will and purpose? If so, what language in the Act compels such an absurdity? While the Commissioner's interpretation of the term "net income," as used in Section 23 (n) inflicts a more serious injury to TAXPAYER "A," than to the respondent here, the principle is the same. The two cases are precisely parallel in law. In both cases the base for the allowance of contributions is lost according to the Commis-

sion because the capital net loss exceeds the net income subject to the normal and surtaxes.

Does TAXPAYER "A," have to pay a tax of $164,-850.00 on taxable net income, and yet have no base under Section 23 (n) for the allowance of a deduction for contributions? For "net income," the base specified in Section 23 (n), the Commissioner would substitute a net loss of $100,000, as computed without the benefit of a deduction for contributions. The *base for calculation of the tax* in the case of TAXPAYER "A," is not a net loss of $100,000.00. If it were, no tax would be payable.

We contend that TAXPAYER "A's" "net income," as computed without the benefit of the deduction for contributions was $450,000.00, consisting of total income of $500,000 minus $50,000, representing interest and taxes paid, and we earnestly maintain that the respondent's "net income," as aforesaid for the year 1932, was $94,963.52. In both cases the amounts deducted for contributions were within the 15% limitation prescribed by Section 23 (n).

In the case of *John E. Zimmermann* v. *Commissioner*, 36 B. T. A. 618, presently pending before the Third Circuit on appeal from the Board's decision, the Commissioner is claiming a deficiency in income tax of $11,632.23 on Zimmermann's *net income* consisting of ordinary net income of $129,434.81 as computed without the benefit of a deduction for contributions. Zimmermann claimed a deduction of $17,178.64 for contributions to charity, but the Commissioner denied the deduction in its entirety, because Zimmermann sustained a *capital net loss* of $267,252.87, which exceeded his taxable net income.

Did Congress by the adoption of the capital net loss provisions of Section 101 intend to invade Section 23 (n) and impair or destroy the deduction for con-

tributions in a case where the taxpayer had a net income subject to tax, and paid an income tax? Is such a taxpayer to lose his deduction for contributions in the process of losing a deduction for a net loss sustained from the sale of investment property held for more than two years, which is denominated a "capital net loss," by Section 101 (c) (6)? We fail to find any language in the Act, or any legislative history, which evinces any such incongruous purpose. To our minds, Section 101 displays careful legislative draftsmanship, and the provisions thereof dovetail well with the balance of the Act when given a fair and reasonable interpretation consistent with the legislative purpose.

To illustrate further the destructive effect on the deduction for contributions produced by attributing to the term *net income* as used in Section 23 (n) the meaning taxable net income less the nondeductible capital net loss:

TAXPAYER "B"

INCOME

Item and Instruction No.*			
2.	Income from Business or Profession	$175,000.00	
8.	Profit from Sale of Real Estate, Stocks, Bonds, etc. (from Schedule C)	25,000.00 (loss)	
10.	Dividends	25,000.00	
12.	Total Income		$175,000.00
	DEDUCTIONS		
14.	Taxes Paid	1,500.00	
17.	Contributions	15,000.00	
19.	Total Deductions		16,500.00
20.	Net Income		$158,500.00
22.	Net Income for Tax Computation		$158,500.00
	COMPUTATION OF TAX (See Instruction 23)		
23.	Net Income Subject to Tax		$158,500.00
25.	Less Dividends	$25,000.00	
26.	Personal Exemption	2,500.00	
28.	Total of Items 24 to 27		27,500.00
29.	Balance subject to Normal Tax (Item 23 minus Item 28)		$131,000.00
30.	Amount taxable at 4%		4,000.00
31.	Amount taxable at 8%		$127,000.00
32.	Amount of Capital Net Gain or Loss (From Schedule D)	(loss)	$125,000.00
33.	Normal Tax (4% of line 30)		$ 160.00
34.	Normal Tax (8% of line 31)		$ 10,160.00
35.	Surtax on Item 22		$ 50,625.00
36.	Tax on Net Income (total of Items 33 to 35)		$ 60,945.00
37.	Adjustment for Capital Gain or Loss (12½% of Item 32)		15,625.00
38.	Total Tax (difference between lines 36 and 37		$ 45,320.00

*Please see the specimen return and instructions, Form 1040, for the calendar year 1932 appearing at pages 22,968-22,979, Prentice-Hall Tax Service, 1933.

In the above example, TAXPAYER "B," in the year 1932 contributed $15,000.00 to charitable institutions. He reported a "net income," within the meaning of that term as used in Sections 11 and 12 of $158,500.00 after deducting contributions, and a "capital net loss," within the meaning of that term as used in Section 101 (c) (6) of $125,000.00. His normal and surtaxes under Sections 11 and 12 on his "net income," of $158,500.00 were shown to be $60,945.00, against which he applied a credit of $15,625.00, representing 12½% of

his capital net loss of $125,000.00. He reported the difference, or $45,320.00, as the total tax due.

Now, what happens in the case of TAXPAYER "B?" He would also receive a deficiency notice from the Commissioner of Internal Revenue. While he would not suffer the misfortune of losing his deduction for contributions entirely, it would be cut down materially. In the Commissioner's view, TAXPAYER "B's" "net income," within the contemplation of that term as used in Section 23 (n) as computed without the benefit of the deduction for contributions, was $48,500.00, consisting of "ordinary net income," of $173,500.00 without the deduction, reduced by the "capital net loss," of $125,000.00. TAXPAYER "B," would be granted a deduction of $7,275.00, being 15% of $48,500.00, in lieu of the claimed deduction of $15,000.00. The balance of contributions in the amount of $7,725.00 would be disallowed because it exceeded the 15% limitation, and the Commissioner would claim a deficiency in tax of $4,403.25.

For "net income," the base specified in Section 23 (n), the Commissioner would substitute $48,500.00, the taxable net income less the nondeductible capital net loss. The sum of $48,500.00 is not the *base for the calculation of the tax*. If it were, TAXPAYER "B," would not have to pay a tax of $45,320.00.

In the case of *Howard Heinz* v. *Commissioner*, 34 B. T. A. 885, affirmed (CCA 3) February 11, 1938, 94 F. (2d) 832, now pending before the Third Circuit on petition for rehearing, Heinz in the year 1931 contributed $45,910.37 to charity, but the Commissioner reduced the allowable deduction to $28,031.86, and in the year 1932 Heinz contributed $51,571.40 to charity, but the Commissioner reduced the deduction to $4,-987.64. Heinz's net income subject to tax under Section 12 for 1931, as computed without the deduction

for contributions, was $375,844.65. Heinz paid an income tax of $25,302.90 for 1931, and the Commissioner claims a deficiency in tax of $11,428.86 for that year. Heinz sustained a nondeductible capital net loss of $186,879.09 in 1931. Heinz's net income subject to tax under Sections 11 and 12 for 1932, as computed before the deduction for contributions, was $412,017.69. Heinz paid an income tax of $108,842.23 for 1932, and the Commissioner claims a deficiency in tax of $22,633.73 for that year. Heinz sustained a nondeductible capital net loss of $378,766.79 in 1932.

The *Heinz* case was tried on a stipulation of facts which was confusing. (R. 23.) It read in part as follows:

> "10. The petitioner's taxable net income for the year 1931, as reflected by the notice of deficiency for that year (before the allowance of any deduction for contributions pursuant to Section 23 (n) of the Revenue Act of 1928) is $186,879.09. Said amount of $186,879.09 consists of ordinary net income in the amount of $375,844.65 and capital net loss in the amount of $186,965.56.
> * * *
>
> "13. In his income tax return for the year 1931, the petitioner claimed a deduction as and for contributions in the amount of $45,910.37. In arriving at the deficiency involved for the year 1931, the respondent determined the petitioner's allowable deduction for contributions for that year to be $28,031.86 (15 % of $186,879.09 equals $28,031.86).
>
> "14. The petitioner's taxable net income for the year 1932, as reflected by the notice of deficiency for that year (before the allowance of any deduction for contributions pursuant to Section 23 (n) of the Revenue Act of 1932) is $33,250.90. Said amount of $33,250.90 consists of ordinary net income in the amount of $412,017.69 and capital net loss of $378,766.79.
> * * *

"17. In his income tax return for the year 1932, the petitioner claimed a deduction as and for contributions in the amount of $51,571.40. In arriving at the deficiency involved for the year 1932, the respondent determined the petitioner's allowable deduction for contributions for that year to be $4,987.64 (15% of $33,250.09 equals $4,987.64)."

How can the Commissioner consistently hold that the total tax assessable against Heinz for 1932 on his taxable net income is $131,476.06, of which Heinz previously paid $108,842.23, and at the same time hold that for the purpose of Section 23 (n) his "net income," is only $33,250.09? The said sum of $33,250.09 is not the base under the Act for the *calculation of the tax.* If it were, it would not produce a tax liability of $131,476.06. The Commissioner did not allow Heinz any deduction for his *capital net loss* in computing his net income subject to tax under Sections 11 and 12. A capital net loss serves as the base for the allowance of a credit of 12½% per cent thereof against the normal and surtaxs, not as a deduction from gross income.

Board Member Sternhagen, who announced the opinion of the full Board in the *Heinz* case, supra, 34 B. T. A. 885, 900 (decided August 7, 1936), made the following pertinent observation:

> "In the instant case it will be seen that the capital loss provision indirectly works to the petitioner's advantage, when read in conjunction with the provision for deducting charitable contributions, for while the former section limits the amount of losses to the petitioner's disadvantage, it increases the amount of his total net income, and to that extent, therefore, enlarges the charitable deduction which is measured by a percentage of that income. The ameliorative purpose of the two sections is therefore retained here. And there is nothing in the Bliss decision which warwants going farther."

The above language supports the taxpayer's view of the statute. The exclusion of the capital net loss as required by the statute without question serves to increase the amount of a taxpayer's total net income and to enlarge the base for the calculation of the 15 per cent limitation which is measured by a percentage of that net income. This is precisely what we contend. When the tax was recomputed in the *Heinz* case under Rule 50 of the Board's rules of practice, however, the deduction for contributions was based on a net income decreased by the capital net loss.

A stipulation which attempts to resolve a controverted issue of law is not binding on a Court. In *Swift & Co.* v. *Hocking Valley R. Co.*, 243 U. S. 281, 289, Mr. Justice Brandeis, speaking for the Court, said:

> "If the stipulation is to be treated as an agreement concerning the legal effect of admitted facts, it is obviously inoperative; since the court cannot be controlled by agreement of counsel on a subsidiary question of law. See cases cited in margin. If the stipulation is to be treated as an attempt to agree 'for the purpose only of reviewing the judgment' below, that what are the facts shall be assumed not to be facts, a moot or fictitious case is presented. 'The duty of this court, as of every judicial tribunal, is limited to determining rights of persons or of property, which are actually controverted in the particular case before it * * * No stipulation of parties or counsel, whether in the case before the court or in any other case, can enlarge the power, or affect the duty, of the court in this regard.' *California* v. *San Pablo & T. R. Co.*, 149 U. S. 308, 314, 37 L. ed. 747, 748, 13 Sup. Ct. Rep. 876. See *Mills* v. *Green*, 159 U. S. 651, 654, 40 L. ed. 293, 294, 16 Sup. Ct. Rep. 132. The fact that effect was given to the stipulation by the appellate courts of Ohio does not conclude this court. See *Tyler v. Judges of Ct. of Registration*, 179 U. S. 405, 410, 45 L.

ed. 252, 254, 21 Sup. Ct. Rep. 206. We treat the stipulation, therefore, as a nullity."

The Third Circuit in the *Heinz* case, 94 F. (2d) 832, 833, said in part as follows:

> "The sole question here raised is whether the deductions allowed for charitable contributions shall be measured by a percentage of the net income or income before *capital losses* are deducted. * * *."

That was not a correct statement of the issue. The question is whether in determining the base for the calculation of the 15 per cent limitation, a *capital net loss*, as defined by Section 101 (c) (6), not a *capital loss*, as defined by Section 101 (c) (2), was to be treated as a permissible deduction. In other words, is the base to be reduced by the *capital net loss?* A *capital loss* as defined by Section 101 (c) (2) is deductible from a *capital gain* as defined by Section 101 (c) (1) in computing *capital net gain* as defined by Section 101 (c) (5). A *capital net loss* as defined by Section 101 (c) (6) is the excess of the sum of the capital losses plus capital deductions over the total amount of capital gain. In other words, it is the net loss on the sale of assets held by a taxpayer for more than two years denominated by Section 101 (c) (8) as *capital assets*, and by the express language of Section 101 (c) (7) such net loss was excluded in arriving at the *net income* which was to be taxed at the normal and surtax rates under Sections 11 and 12. That section also requires the exclusion of a capital net gain. The ordinary net income is the net income to be taxed under Sections 11 and 12, and the capital net gain is the net income to be taxed at 12½ per cent under Section 101 (a). In the case at bar the taxpayer's sole net income was his ordinary net income.

In *Lockhart* v. *Commissioner*, 32 B. T. A. 732, affirmed (CCA 3), 89 F. (2d) 143, the stipulation of facts provided in part as follows:

> "1. Petitioner's taxable net income for the year 1929 (before the allowance of any deduction for contributions pursuant to Section 23 (n) of the Revenue Act of 1928) is $911,599.10.
>
> "2. Said amount of $911,599.10 consists of ordinary income in the amount of $966,467.20 and capital net loss in the amount of $54,868.10.
>
> "3. During the year 1929 petitioner made contributions or gifts to the persons and organizations specified and described in Section 23 (n) of the Revenue Act of 1928 in the total amount of at least $144,970.08.
>
> * * *
>
> "5. The deduction for contributions claimed in petitioner's income tax return for the year 1929 was $131,200.84. The deduction for contributions allowed by the Commissioner in determining the deficiency was $202,162.06. The Commissioner contends that the amount of petitioner's allowable deduction for contributions is $136,739.87, viz. 15% of $911,599.10. Petitioner contends that the entire amount of $144,970.08, viz., 15% of $966,467.20, is allowable as a deduction in computing his ordinary net income subject to normal and surtaxes."

The capital net loss in that case was not treated by the Commissioner as a permissible deduction in computing the net income subject to the normal and surtaxes imposed by Sections 11 and 12.

In the Government's brief in this case reference is made to I. T. 2104, Cumulative Bulletin III-2, page 152, as supporting the conclusion that a *capital net loss* should not be excluded in computing the net income contemplated by Section 23 (n). The Commissioner by his action in the respondent's case did exclude it in computing the net income contemplated by Sections 21,

22 and 23, and Sections 11 and 12. I. T. 2104 did not hold that a *capital net loss* is a permissible deduction in computing net income. It held that *capital losses* are deductible. Capital losses are deductible to the extent of the capital gains, but the excess of such losses over gains is a *capital net loss* which is not a permissible deduction. This Court in the *Bliss* case prefixed its reference to the Bureau rulings by the word "See." This was perfectly proper, and implies no approval of I. T. 2104. This ruling provides in part as follows:

> "Advice is requested as to whether capital losses may be excluded in determining net income for the purpose of computing the amount of charitable contributions allowable as deductions under the Revenue Acts of 1918, 1921, and 1924. * * * "Inasmuch as losses resulting from the sale or exchange of capital assets are deductible under section 214 of the Revenue Acts of 1918, 1921, and 1924, and enter into the computation of the net loss that is deductible under section 206 of the Revenue Act of 1924, it follows that such losses can not be excluded in computing the net income for the purpose of determining the amount of charitable contributions that are deductible under section 214 (a) 11 of the Revenue Acts of 1918 and 1921 and section 214 (a) 10 of the Revenue Act of 1924."

This ruling does not hold, as suggested by the petitioner that a "capital net loss" must be subtracted from "ordinary net income," as computed without a deduction for contributions, in arriving at the base for calculation of the 15% limitation. There is quite a distinction between a "capital loss," and a "capital net loss." See Section 208 (a) (2) and (6), Revenue Act of 1924, and Section 101 (c) (2) and (6), Revenue Act of 1932. A "capital net loss" is not a permissible deduction in computing a "net loss,"

which is to be carried forward to a subsequent taxable year, and if I. T. 2104 so holds by implication, it is void, as being contrary to law.

Section 206 (a) of the Revenue Act of 1924 provides in part as follows:

> "Sec. 206. (a) As used in this section the term 'net loss' means the excess of the deductions allowed by section 214 or 234 over the gross income, with the following exceptions and limitations: * * *—
>
> "(2) In the case of a taxpayer other than a corporation, deductions for capital losses otherwise allowed by law shall be allowed only to the extent of the capital gains; * * *."

The law is the same under the Revenue Act of 1932 which controls the instant case. See Sections 23 (i) and 117 (a) (2), Revenue Act of 1932.

If a *capital net loss* is a permissible deduction in computing net income, why was it that the Commissioner did not allow it as such in computing the respondent's net income subject to tax? A capital loss is a permissible deduction under certain circumstances. Capital losses are deductible from capital gains in ascertaining a capital net gain. Capital losses are deductible to the extent of capital gains, but the excess of such losses over gains is a capital net loss, which is not a permissible deduction.

I. T. 2104 is a correct ruling as applied to deductible capital losses. It does not hold that a capital net loss is deductible, and the Commissioner in the administration of Section 206 (a) of the Revenue Act of 1924 has never allowed a capital net loss—the excess of capital losses over gains—as a deduction in computing a net loss to be deducted in a succeeding taxable year. So to construe the statute would contravene Section 206 (a) (2). Section 117 (a) (7) of the Revenue Act of 1932 similarly limits the deduction of capital losses.

The Revenue Act of 1932 by Section 23 (r) (1) limited the deduction of losses on the sale or exchange of noncapital assets to the amount of the gains. To illustrate, if a taxpayer had gains of $10,000.00 and losses of $50,000.00, the gains of $10,000.00 are includable in gross income, and the deduction for losses is limited to $10,000.00. The excess of the losses over gains, or $40,000.00, is not a permissible deduction. Section 23 (r) (1) of the 1932 Act provided as follows:

> "(r) Limitation on Stock Losses.—
>
> "(1) Losses from sales or exchanges of stocks and bonds (as defined in subsection (t) of this section) which are not capital assets (as defined in section 101) shall be allowed only to the extent of the gains from such sales or exchanges (including gains which may be derived by a taxpayer from the retirement of his own obligations)."

Section 23 (r) (2) providing for the deduction in a succeeding taxable year of the disallowed loss under Section 23 (r) (1) was repealed by Section 218 (b) of the National Industrial Recovery Act, approved June 16, 1933.

While the administrative practice of the Commissioner under the Revenue Acts of 1924, 1926, 1928 and 1932 has been uniform in holding that a *capital net loss* was not a permissible deduction in computing net income subject to tax, or in computing a net loss for carryover purposes, his practice of decreasing taxable net income by a nondeductible capital net loss for the purpose of Section 23 (n) has been one of inconsistency of long standing. The Revenue Act of 1924 introduced the capital net loss provisions. The full Board disapproved the practice of deducting a nondeductible capital net loss in *Hallie D. Elkins*, 24 B. T. A. 572 (decided November 3, 1931). This was the first case

to be decided by the Board wherein the administrative practice was shown. Then subsequently *Charles J. Livingood*, 25 B. T. A. 585 (decided February 23, 1932) also held in favor of the taxpayer on the same issue. The Commissioner did not appeal from those decisions. Cumulative Bulletin XI-2, July-December, 1932, p. 3, shows the Commissioner's acquiescence in the decision of the Board in the *Elkins* case. Cumulative Bulletin XIII-2, July-December, 1934, p. 25 reports a subsequent nonacquiescence.

Under the Revenue Act of 1934 and subsequent Acts, certain percentages of gain or loss are recognized on the sale or exchange of capital assets, dependent on the length of time the assets were held. Where there is an excess of recognized losses over recognized gains, the deduction for losses is limited to $2,000.00, and the balance is disallowed in the same manner as a "capital net loss," is disallowed under the Revenue Act of 1932. See Section 117, Revenue Act of 1934.

The Commissioner in the instant case recognizes that a capital net loss is not a permissible deduction in ascertaining the net income for the imposition of the tax, but refuses to apply the same rule in administering Section 23 (n).

This Court in the *Bliss* case recognized that *net income* consisting of *ordinary net income* is part of the base specified in Section 23 (n). The respondent here has an *ordinary net income* and since it constitutes his sole net income, it constitutes the base for the purpose of Section 23 (n). A capital net loss is not a part of taxable net income, and is not a permissible deduction in computing the same. It is not the base for the calculation of the tax. It is the base for the calculation of a credit against tax.

This Court in the *Bliss* case, 293 U. S. 144, 148-150, further said:

"Commencing with the Revenue Act of 1921 Congress, in order to encourage realization of profits on capital assets, saw fit to relieve gain thus derived of the heavy surtaxes then applicable, and to permit the payment of tax at a flat rate of 12½ per cent on so much of the taxpayer's income as represented the net gain from capital transactions.

"The accomplishment of this purpose of applying two rates to two different kinds of net income, required new provisions as to the base for each rate. Section 101 of the Revenue Act of 1928 prescribes the method to be followed. * * * In extending this relief to taxpayers, Congress might have modified the privilege theretofore existing with respect to charitable contributions, by directing that they should be deducted solely from capital net gain or should be apportioned and deducted ratably from ordinary net income and from capital net gain. The Acts, however, evince no such purpose. In the Act of 1928, as will be seen by reference to Sections 21, 22 and 23 the statutory concept of net income is preserved. These sections are found in part II of title I, which deals with 'Computation of Net Income.' Section 101, on the other hand, is found under 'Supplemental Provisions,' and is captioned 'Supplement A-Rates of Tax.' It is obviously directed to the matter of computation of tax on a portion of net income as defined in Section 21. There is nothing novel in such a division of the statutory net income into parts for the purpose of applying different rates of tax * * *."

The statutory net income in the *Bliss* case comprised two parts (1) net income consisting of ordinary net income subject to tax under Sections 11 and 12, and (2) net income consisting of

capital net gain taxed specially at 12½ per cent under Section 101 (a). The entire taxable net income consisting of a total of the two parts was held to constitute the base specified in Section 23 (n) for calculating the 15 per cent limitation in the *Bliss* case.

The respondent's net income consisting of ordinary net income of $94,963.52 was his entire taxable net income. It was his net income within the meaning of Sections 21, 22 and 23, otherwise it could not have been taxed as net income under Sections 11 and 12. These sections levy a tax on net income. While Sections 21, 22 and 23 govern principally the determination of statutory net income—the base for calculation of the tax—Sections 24, 41-48, 101 (5), 101 (7), 111, 112, 113, 114, 115, 116, 117, 118, 120 and others do affect its computation.

The *Bliss* case recognized that ordinary net income was net income within the meaning of Section 21, otherwise it could not have formed part of net income—the base specified in Section 23 (n). In the *Bliss* case this Court employed ordinary net income as part of the base under Section 23 (n).

This Court in the *Bliss* case, 293 U. S. 144, 150, further said:

> "The plain requirements of Section 101 are that in ascertaining ordinary net income there shall be excluded from the computation only items of capital gain, capital loss and capital deductions. Charitable contributions covered by Section 23 (n) obviously are not capital deductions as defined by Section 101 (c) (3), but on the contrary are 'ordinary deductions' within the meaning of Section 101 (c) (4).
>
> "By the express words of Section 23 (n) charitable contributions are to be deducted to ascertain net income as defined in Section 21; and nothing in Section 101, which prescribes merely a method for segregating a portion of that net

income for taxation at a special rate, in any wise, alters the right of the taxpayer to take the deduction in accordance with Section 23 (n)."

Section 101 (c) (7) provided as follows:

> "(7) 'Ordinary net income' means the *net income*, computed in accordance with the provisions of this title, after excluding all items of capital gain, capital loss, and capital deductions."

This section denominates ordinary net income as net income. The language, "computed in accordance with the provisions of this title," obviously means in accordance with Sections 21, 22 and 23, because they were part of "this title," being Title I. The language of exclusion, "after excluding all items of capital gain, capital loss, and capital deductions," embrace either a capital net gain or capital net loss. The language of exclusion, however, does not require the exclusion of the ordinary deduction for contributions. This Court recognized that the deduction for contributions was an ordinary deduction in the computation of the taxpayer's ordinary net income. We earnestly maintain that the respondent here is entitled to a deduction for contributions in ascertaining his ordinary net income in the same manner as *Bliss* was accorded such a deduction in computing her ordinary net income. The Act prescribes one method of ascertaining ordinary net income, regardless of whether the taxpayer enjoys a capital net gain, or suffers a capital net loss. The Act did not contemplate discrimination in the ascertainment of ordinary net income.

This Court in the *Bliss* case, 293 U. S. 144, 150-151, further said:

> "If the meaning of the Act were doubtful, we should still reach the same conclusion. The exemption of income devoted to charity and the

reduction of the rate of tax on capital gains were liberalizations of the law in the taxpayer's favor, were begotten from motives of public policy, and are not to be narrowly construed. Nor should the reduction in the rate of tax on capital gain, first granted in the Revenue Act of 1921, be held to circumscribe the privilege granted in the earlier Acts, and retained in the later ones, with respect to charitable contributions, unless that result be plainly required by the language used. As has been shown the statutes if read as written lead to a contrary result. Moreover, from 1923 to 1932 the Commissioner uniformly ruled that the deduction for charitable contributions was to be taken from net income before computation of the tax and hence in whole from ordinary net income. The reenactment in later Acts of the sections permitting the deduction indicates Congressional approval of this administrative interpretation."

The respondent here is similarly entitled to a deduction for his contributions before computation of the tax, and in whole from his ordinary net income, which which was his sole net income. The only exception to the rule that the deduction for contributions must be taken in whole from ordinary net income is found in *Straus* v. *Commissioner*, 27 B. T. A. 1116, affirmed 74 F. (2d) 470, when the ordinary deductions, including the deduction for contributions, exceed the ordinary income. In such a case, the excess by the express language of Section 101 (c) (5) is deducted from the capital net gain, and the balance is subjected to the 12½ per cent rate. (See Report No. 179, p. 19, 68th Cong., 1st Sess., House Ways and Means Committee, covering the Revenue Bill of 1924.)

II

The design of Congress in the enactment of Section 23 (n), authorizing a deduction for charitable contributions, was to encourage taxpayers to make such contributions, and the Act should therefore be construed so as to effectuate that policy.

The provision permitting a deduction for contributions was originally incorporated in the Revenue Act of 1917. Section 1201 (2) of that Act, amending the Act of 1916, provided in part as follows:

> "(2) That section five of such Act of September eighth, nineteen hundred and sixteen, is hereby amended by adding at the end of subdivision (a) a further paragraph, numbered nine, to read as follows:
>
> " 'Ninth. Contributions or gifts actually made within the year * * * *to an amount not in excess of fifteen per centum of the taxpayer's taxable net income as computed without the benefit of this paragraph* * * * .' " (Italics supplied.)

The Revenue Acts of 1918, 1921, 1924, 1926, 1928, 1932, 1934, 1936 and 1938 similarly permitted a deduction for charitable contributions to an amount not in excess of 15% of the taxpayer's net income as computed without the benefit of the deduction, thus plainly evincing a continual legislative policy of encouraging taxpayers to sustain the charitable institutions of this country. This legislation has served a useful, beneficent purpose, and it works when given a proper interpretation.

The beneficent purpose of the deduction for charitable contributions was recognized in *Young Men's Christian Association* v. *Davis*, 264 U. S. 47, 50, *Old Colony Trust Co.* v. *Commissioner*, 301 U. S. 379, 384 and *Helvering* v. *Bliss*, supra.

Congress intended by Section 23 (n) to free from

tax an amount of taxable net income equal to the amount of the contributions within the limit of 15 per cent of such net income. In this way, a taxpayer donating to charity effected a saving in tax, but the Commissioner has denied the respondent here the benefit of the same.

The statute as construed by the Commissioner produces a positive repugnancy between the term "net income," as used in Section 23 (n), and the same term as used in other parts of the Act, with absurd consequences. This should be avoided unless the statute plainly requires it.

In *Bernier v. Bernier*, 147 U. S. 242, 246, Mr. Justice Field, who delivered the opinion of the Court, said:

> "* * All acts of the legislature should be so construed, if practicable, that one section will not defeat or destroy another, but explain and support it. When a provision admits of more than one construction, that one will be adopted which best serves to carry out the purposes of the act * * *."

The case of *U. S.* v. *Freeman*, 3 Howard 556, 44 U. S. also contains an excellent expression on this subject. Mr. Justice Wayne, who announced the opinion of the Court said:

> "* * * In 4 Dall. 14, 'The intention of the Legislature, when discovered, must prevail, any rule of construction declared by previous acts to the contrary notwithstanding.' In 2 Cranch, 33, (A law is the best expositor of itself—that every part of an act is to be taken into view for the purpose of discovering the mind of the Legislature,' etc. In the case of The United States v. Fisher et al., Assignees of Blight, in the same book, the court said, 'It is undoubtedly a well established principle in the exposition of statutes,

that every part is to be considered, and the intention of the Legislature to be extracted from the whole.' In 2 Peters, 662, 'A legislative act is to be interpreted according to the intention of the Legislature, apparent upon its face. Every technical rule, as to the construction or force of particular terms, must yield to the clear expression of the paramount will of the Legislature.' In Paine's C. C. Rep. 11, 'In doubtful cases, a court should compare all the parts of a statute, and different statutes in pari materia, to ascertain the intention of the legislature.' So in 1 Brockenb, C. C. Rep., 162. In the construction of statutes, one part must be construed by another. In order to test the legislative intention, the whole statute must be inspected * * *."

In *Ozawa* v. *U. S.*, 260 U. S. 178, 194, this Court, speaking through Mr. Justice Sutherland, said:

"It is the duty of this court to give effect to the intent of Congress. Primarily this intent is ascertained by giving the words their natural significance; but if this leads to an unreasonable result, plainly at variance with the policy of the legislation as a whole, we must examine the matter further. We may then look to the reason of the enactment, and inquire into its antecedent history, and give it effect in accordance with its design and purpose, sacrificing, if necessary, the literal meaning in order that the purpose may not fail. See Church of the Holy Trinity v. United States, 143 U. S. 457, 36 L. ed 226, 12 Sup. Ct. Rep. 511; Heydenfeldt v. Daney Gold & S. Min. Co., 93 U. S. 634, 638, 23 L. ed. 995, 996, 13 Mor. Min. Rep. 204. * * *."

In *U. S.* v. *Katz*, 271 U. S. 354, 357, Mr. Justice Stone, who delivered the opinion of the Court, made the following pertinent observations:

"All laws are to be given a sensible construction; and a literal application of a statute, which

would lead to absurd consequences, should be avoided whenever a reasonable application can be given to it, consistent with the legislative purpose. See Hawaii v. Mankichi, 190 U. S. 197, 212, 47 L. ed. 1016, 1020, 23 Sup. Ct. Rep. 787, 12 Am. Crim. Rep. 465, and cases there cited. In ascertaining that purpose, we may examine the title of the act (United States vs. Fisher, 2 Cranch, 358, 386, 2 L. ed. 304, 313; United States v. Palmer, 3 Wheat 610, 631, 4 L. ed. 471, 477; Church of the Holy Trinity v. United States, 143 U. S. 457, 462, 36 L. ed. 226, 229, 12 Sup. Ct. Rep. 516), the source in previous legislation of the particular provision in question (United States v. Saunders, 22 Wall. 492, 22 L. ed. 736; Viterbo v. Friedlander, 120 U. S. 707, 30 L. ed. 776, 7 Sup. Ct. Rep. 962; United States v. Morrow, 266 U. S. 531, 535, 69 L. ed. 425, 427, 45 Sup. Ct. Rep. 173), and the legislative scheme or plan by which the general purpose of the act is to be carried out. See Platt v. Union P. R. Co., 99 U. S. 48, 63, 64, 25 L. ed. 424, 429; Bernier v. Bernier, 147 U. S. 242, 246, 37 L. ed. 152, 154, 13 Sup. Ct. Rep. 244."

Chief Justice Marshall in *U. S.* v. *Fisher* et al., 3 Cranch 358, 386, 6 U. S. well said:

"* * * Where the mind labors to discover the design of the legislature, it seizes everything from which aid can be derived * * *."

When we cast our minds beyond Sections 11 and 12 and Section 101 to test the meaning of the term "net income," as used in Section 23 (n) as applied to the facts here, and explore other parts of the Act, the respondent's view of the law is confirmed.

Section 120 of the Revenue Act of 1932 provides as follows:

"In the case of an individual if in the taxable year and in each of the ten preceding taxable

> years the amount of the contributions or gifts described in Section 23 (n) plus the amount of income, war-profits, or excess-profits taxes paid during such year in respect of preceding taxable years, exceeds 90 per centum of the taxpayer's *net income* for each such year, as computed without the benefit of section 23 (n), then the 15 per centum limit imposed by such section shall not be applicable." (Italics supplied.)

Does the term "net income," as used in Section 120 mean total net income subject to tax, or does it mean in the case of a "capital net loss," ordinary net income minus capital net loss?

The term "net income," cannot be contracted for the purpose of Section 23 (n), and expanded for other purposes. No such duplicity of purpose is evinced by the language of the Act.

Under the Act, each taxpayer has a definite total taxable net income which is not variable, and this amount without the deduction for contributions is the base for the purpose of the 15% limitation contained in Section 23 (n), irrespective of whether the taxpayer enjoyed a "capital net gain," or suffered a "capital net loss." Different parts of the net income may be subjected to different rates of tax, but the "net income," contemplated by Section 23 (n) is the whole of the parts as computed without the benefit of a deduction for contributions. Sections 11 and 12 impose normal taxes of 4% and 8%, and surtaxes of 1% to 55% on different parts of "ordinary net income." Section 25 provides for the allowance of credits for dividends and interest on United States obligations for normal tax purposes. Section 101 offers a special tax of 12½% on "capital net gain." Section 102 provides a limitation of 16% on the selling price of mines, oil or gas wells for surtax purposes.

Does the term "net income," as used in Section 131 of the Revenue Act of 1932 have a meaning at variance with the meaning of the same term as used in Section 23 (n)? Section 131 permits a credit against the tax imposed by Title I of the Act for income taxes paid to foreign countries and possessions of the United States. Section 131 (b) imposed a limitation on the credit and reads as follows:

> "(b) Limit on Credit. The amount of the credit taken under this section shall be subject to each of the following limitations:
>
> "(1) The amount of the credit in respect of the tax paid or accrued to any country shall not exceed the same proportion of the tax against which such credit is taken, which the taxpayer's net income from sources within such country bears to his entire *net income* for the same taxable year; and
>
> "(2) The total amount of the credit shall not exceed the same proportion of the tax against which such credit is taken, which the taxpayer's net income from sources without the United States bears to his entire *net income* for the same taxable year." (Italics supplied.)

Does the term "net income," as used in Section 131 (b) mean "ordinary net income," minus "capital net loss" in the case of an American citizen who has sustained a "capital net loss," which is excluded in arriving at his net income subject to tax? The answer is "No," according to the General Counsel for the Department of the Treasury. In G. C. M. 16144, XV-9-7972, Cumulative Bulletin XV-1, January-June, 1936, p. 152, 155, it is stated in part as follows:

> "Where, however, there is a capital net loss instead of a capital net gain, the base of the tax

is not gross income computed under section 22 less deductions allowed by section 23. On the contrary, the base of the computation is the ordinary net income, although the tax on ordinary income is reduced by a percentage of the capital net loss. Therefore, the limitation under Section 131 (b) of the Revenue Act of 1932, where there is a capital net loss, would be expressed as follows:

$$\frac{\text{Net income from sources without U. S.}}{\text{Ordinary net income}} \times \text{U. S. tax} = \text{credit}$$

"* * * In answer to the specific questions submitted, it is held that:

"(1) The credit for foreign taxes may be allowed even though a taxpayer has a capital net loss from sources within the United States which exceeds his ordinary net income.

"(2) Where such capital net loss is less than the ordinary income, the denominator to be used under Section 131 (b) of the Revenue Act of 1932 is 'ordinary net income.'"

"If the term "net income," as used in Section 131 (b) were construed to mean "ordinary net income," minus "capital net loss," then the Congressional plan to limit the credit for foreign taxes would be frustrated. It would serve to enlarge the credit to the point of absorbing the entire U. S. tax.

G. C. M. 16144 holds that in the case of a *capital net loss* the taxpayer's *ordinary net income* is his *net income* within the meaning of that term as used in Section 131 (b) of the Revenue Act of 1932. We think this is a correct interpretation of the statute, and should apply with equal force to Section 23 (n).

We contend that in the case at bar, the respondent's entire net income for the year 1932 as computed with-

out the benefit of a deduction for contributions was $94,963.52 and that this is the base for the calculation of the 15% limitation on the deduction for contributions prescribed by Section 23 (n). G. C. M. 16144 definitely supports this view. It recognizes that a taxpayer's entire net income might consist of ordinary net income. The respondent's net income of $94,963.52 was computed under Sections 21, 22 and 23. The statute required it to be so computed.

The term "net income," is employed in other parts of the Act. If the Commissioner's interpretation of that term as used in Section 23 (n) were applied to the same term appearing elsewhere in the Act, the consequences would be absurd, and the legislative purposes would be nullified.

III

Congress by the adoption of the capital net loss provisions did not intend to deprive a taxpayer who has a taxable net income of a deduction for contributions.

Congress adopted the capital net loss provisions to discourage the practice of taxpayers of selling securities with a view to minimizing taxes. It was designed to protect the revenues of the Government. Section 23 (r) was of similar purpose. See *Edward J. White* v. *Commissioner*, B.T.A. Docket No. 82663, decided June 24, 1938, 37 B.T.A. —. The disallowed loss served to increase taxable net income, and therefore taxes.

Section 101 (b) required two computations of tax, and a taxpayer was required to follow the method that produced the greater tax. It was mandatory, not optional. This is explained in Article 503, Regulations 77, Income Tax, Revenue Act of 1932, reading as follows:

"Art. 503. Capital net losses.—Section 101 (b) provides for the determination of the tax in the case of any taxpayer (other than a corporation, but including the members of a partnership, an estate or trust, or the beneficiaries thereof) who in any taxable year sustains a capital net loss. A 'capital net loss' is the excess of the sum of the capital losses plus the capital deductions as defined in article 501, over the total amount of capital gain as therein defined. It is to be noted that, while the tax provided in section 101 (a) in the case of a capital net gain is to be imposed at the election of the taxpayer, the limitation with respect to a capital net loss provided in section 101 (b) will be applied irrespective of the taxpayer's election.

"In the case of any taxpayer, other than a corporation, who sustains a capital net loss for any taxable year, there shall be levied, collected, and paid, in lieu of the normal tax and the surtax imposed by sections 11, 12, 102, and 211, a tax determined as follows:

"A partial tax will first be computed upon the basis of the ordinary net income, as defined in section 101 (c) (7) and article 501, at the rates and in the manner provided in sections 11, 12, 102, and 211, and the total tax will be this amount minus 12½ per cent of the capital net loss, but in no case shall the tax under section 101 (b) be less than the tax computed without regard to the provisions of section 101. The application of this paragraph may be illustrated by the following example:

"**Example**: During 1932, A had an ordinary net income of $20,000 and a capital net loss of $13,000. He was entitled to a personal exemption of $1,000. The tax computed under section 101 (b) without applying the provision that in no case shall the tax under section 101 (b) be less than the tax computed without regard to the provisions of section 101, would be $175, computed as follows:

Ordinary net income	$20,000
Less credit for personal exemption	1,000
Balance subject to normal tax	19,000
Amount taxable at 4 per cent	4,000
Difference taxable at 8 per cent	15,000
Tax at 4 per cent (4 per cent of $4,000)	160
Tax at 8 per cent (8 per cent of $15,000)	1,200
Total normal tax	1,360
Surtax on $20,000	440
Total tax	1,800
Less: 12½ per cent of the capital net loss (12½% of $13,000)	1,625
Amount of tax	175

"The tax computed without regard to the provisions of section 101 (b) would be $330," computed as follows:

Ordinary net income	$20,000
Capital net loss	13,000
Total net income	7,000
Less credit for personal exemption	1,000
Balance subject to normal tax	6,000
Amount taxable at 4 per cent	4,000
Amount taxable at 8 per cent	2,000
Tax at 4 per cent (4 per cent of $4,000)	160
Tax at 8 per cent (8 per cent of $2,000)	160
Total normal tax	320
Surtax on $7,000	10
Total tax	330

"The correct amount of A's tax is $330, since that amount is greater than the tax computed under section 101 (b) without applying the provisions that in no case shall the tax under section 101 (b) be less than the tax computed, without regard to the provisions of section 101."

Article 501 of Regulations 77 provides: "* * * The tax upon his *net income* from other sources, termed 'ordinary net income' is to be computed at the rates and in the manner provided in sections 11, 12, 102, and 211. * * *." (Italics supplied.)

(Please also see Paragraphs 4944 to 4955, inclusive, Prentice-Hall Tax Service, 1934, on the subject of the tax in the case of a capital net loss.)

This Court in *Helvering* v. *Bliss,* 293 U. S. 144, 150, said:

> "* * * nothing in Section 101, which prescribes merely a method for segregating a portion of that net income for taxation at a special rate, in any wise alters the right of the taxpayer to take the deduction in accordance with Section 23 (n)."

Congress by the adoption of Section 101 did not intend to deprive a taxpayer, who has a taxable net income under the Act, of a deduction for contributions. The legislative purposes of Sections 101 and 23 (n) are unrelated, and both may be effectually accomplished by giving the statute a fair and reasonable interpretation. Congress by Section 101 did not intend to legislate against the deduction for contributions.

In the *Bliss* case, supra, this Court recognized that net income consisting of ordinary net income must be taken into consideration in determining the base under Section 23 (n). The Commissioner now says that such net income reduced by the nondeductible capital net loss is the base. This Court also recognized that the deduction for contributions is a proper deduction in computing ordinary net income. The Commissioner now says that it is not.

Congress in Section 101 used language which safeguarded the ordinary deduction for contributions. Section 101 (c) (4) provides:

> "(4) 'Ordinary deductions' means the deductions allowed by section 23 other than capital losses and capital deductions."

The deduction for contributions is an ordinary deduction allowed by Section 23. Section 101 (c) provides:

"(7) 'Ordinary net income' means the *net income*, computed in accordance with the provisions of this title, after excluding all items of capital gain, capital loss, and capital deductions." (Italics supplied.)

Ordinary net income is *net income*. The statute so provides.

In *C. C. Partee* v. *Commissioner*, B.T.A. Docket No. 81214, 37 B.T.A. —, (decided June 24, 1938), after the decision of the Court of Claims in the *Pleasants* case, it is stated:

"'Ordinary net income' is 'net income' computed after excluding all items of capital gain, capital loss, and capital deductions. The ordinary net income of this petitioner * * * amounted to $45,247.25. Since section 101 provides that a partial tax shall be computed upon the basis of the ordinary net income at the rates and in the manner as if section 101 had not been enacted, "ordinary net income' for the purpose of that computation becomes 'net income.'"

A taxpayer's net income might consist solely of ordinary net income, or it might consist solely of capital net gain, or it might consist of both as happened in the *Bliss* case. But if he has a net income, he has the right to a deduction for contributions. The language of exclusion, "excluding all items of capital gain, capital loss, and capital deductions," following the word, "after," embraced either a capital net loss or a capital net gain. A taxpayer might have a capital net gain or a capital net loss. He cannot have both in the same taxable year. The language of exclusion was necessary in order to arrive at the net income subject to the normal and surtaxes prescribed by Sections 11 and 12, but in the computation of that net income, this Court in the *Bliss* case held that it

was proper to deduct the ordinary deduction for contributions. The language of exclusion did not exclude the ordinary deduction for contributions. Section 101 excluded capital deductions.

IV.

If it is considered that the language of the Act is obscure, then any resulting doubt should be resolved in favor of the taxpayer.

While we earnestly believe that the exemption of income from tax for contributions made, and using as the base for the calculation of the 15% limitation prescribed by Section 23 (n), *total net income subject to tax* as computed without the benefit of the deduction for contributions, irrespective of whether a taxpayer had a "capital net gain," or a "capital net loss," is free from ambiguity, yet if this Court is of the opinion that the language of the Act is obscure, then any resulting doubt should be resolved in favor of the respondent. This principle is well-settled, and was reiterated by Mr. Justice Sutherland, speaking for the Court in *U. S.* v. *Updike*, 281 U. S. 489, 496, in the following language:

> "It may be that the saving clause was not strictly necessary, but was inserted from excessive care to put the right of the taxpayer beyond dispute. In any event, we think this is the fair interpretation of the clause, and the one which must be accepted, especially in view of the rule which requires taxing acts, including provisions of limitation embodied therein, to be construed liberally in favor of the taxpayer. Bowers v. New York & A. Lighterage Co., 273 U. S. 346, 349, 71 L. ed. 676, 678, 47 Sup. Ct. Rep. 389."

This Court in the *Bliss* case, supra, 293 U. S. 144, 150-151, said:

"If the meaning of the Act were doubtful, we should still reach the same conclusion. The exemption of income devoted to charity and the reduction of the rate of tax on capital gains were liberalizations of the law in the taxpayer's favor, were begotten from motives of public policy, and are not to be narrowly construed. * * *"

CONCLUSION

In conclusion, we respectfully submit that the respondent is not to be deprived of his deduction for contributions by some such legal legerdemain; that the base contemplated by Section 23 (n) in the calculation of the 15% limitation on the deduction is the entire net income subject to tax as computed without the benefit of the deduction; that this rule applies equally to a capital net gain case as well as a capital net loss case; that in ascertaining "ordinary net income," both a "capital net gain," and a "capital net loss," are excluded; that in the *Bliss* case, supra, this Court permitted a deduction for contributions in ascertaining "ordinary net income"; that the statute did not prescribe one method of ascertaining "ordinary net income," in the case of a "capital net gain," and a different method of ascertaining "ordinary net income," in the case of a "capital net loss"; that the deduction for contributions is an "ordinary deduction," as applied to both types of cases in ascertaining "ordinary net income"; that Congress did not intend to impair or destroy the deduction for contributions through the introduction of the "capital net gain," and "capital net loss," provisions; that to construe the term "net income," as used in Section 23 (n) to mean "ordinary net income," minus "capital net loss," is to contravene the design of Congress to free from tax income subject to tax equal to the contributions made

within the 15% limitation, and to arrive at a fictitious net income which is not subjected to tax; taxable net income must be the base contemplated by Section 23 (n), because it was this base that was to be freed from tax; that the Commissioner determined the respondent's "net income," within the meaning of that term as used in Sections 11 and 12 to be $94,963.52 as computed without the benefit of the deduction for contributions; that the sum of $94,963.52 is the base contemplated by Section 23 (n) under the facts of this case; that the said sum of $94,963.52 constituted the respondent's entire net income for the year 1932; that the contributions in the sum of $3,496.00 made by the respondent during the year 1932 being within the 15% limitation prescribed by Section 23 (n) are properly deductible; that Section 23 (n) is entitled to a liberal construction in order to effectuate its beneficent purpose that if the language of the Act is of doubtful meaning, such doubt should be resolved in favor of the respondent and that the judgment below should be affirmed.

Respectfully submitted,

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November, 1938.